

Practicalities with implementing tax within Solvency II

November 2011



Agenda

0) Introduction

1) New Life Tax rules

- Simplification?

2) Tax in Solvency II

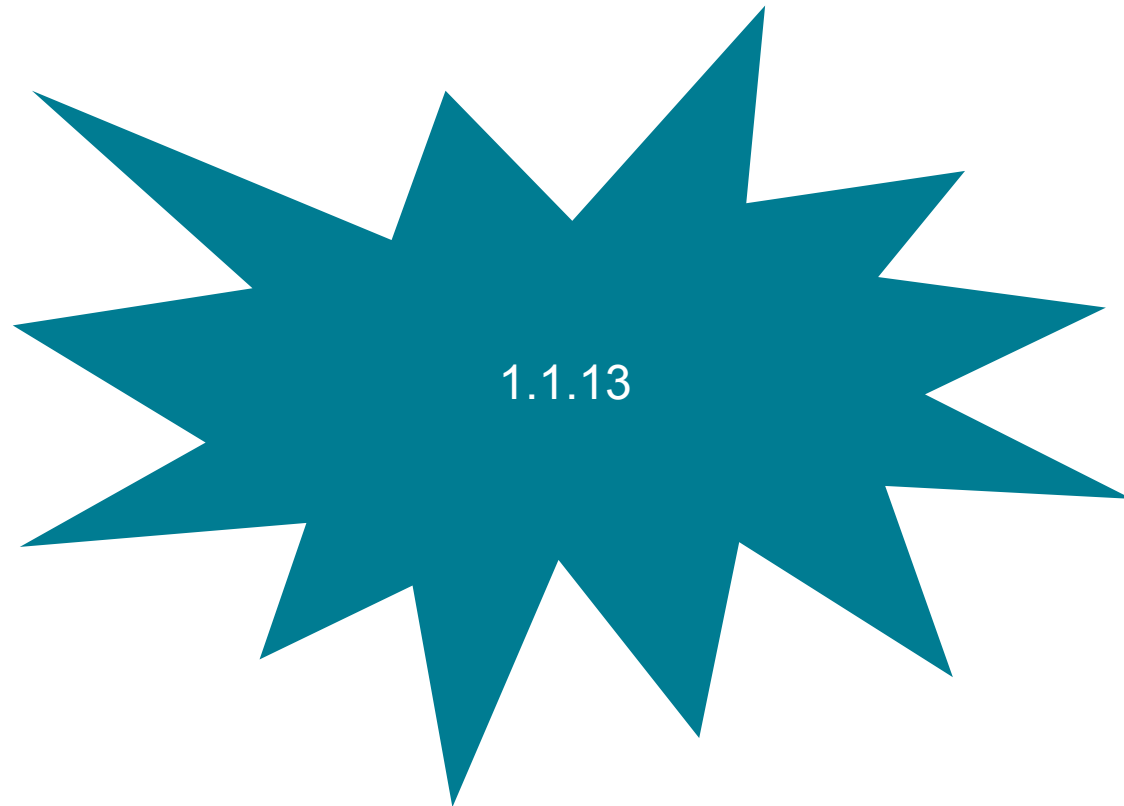
- Best Estimate liabilities
- Loss Absorbency of Deferred Taxes

3) Tax in internal models

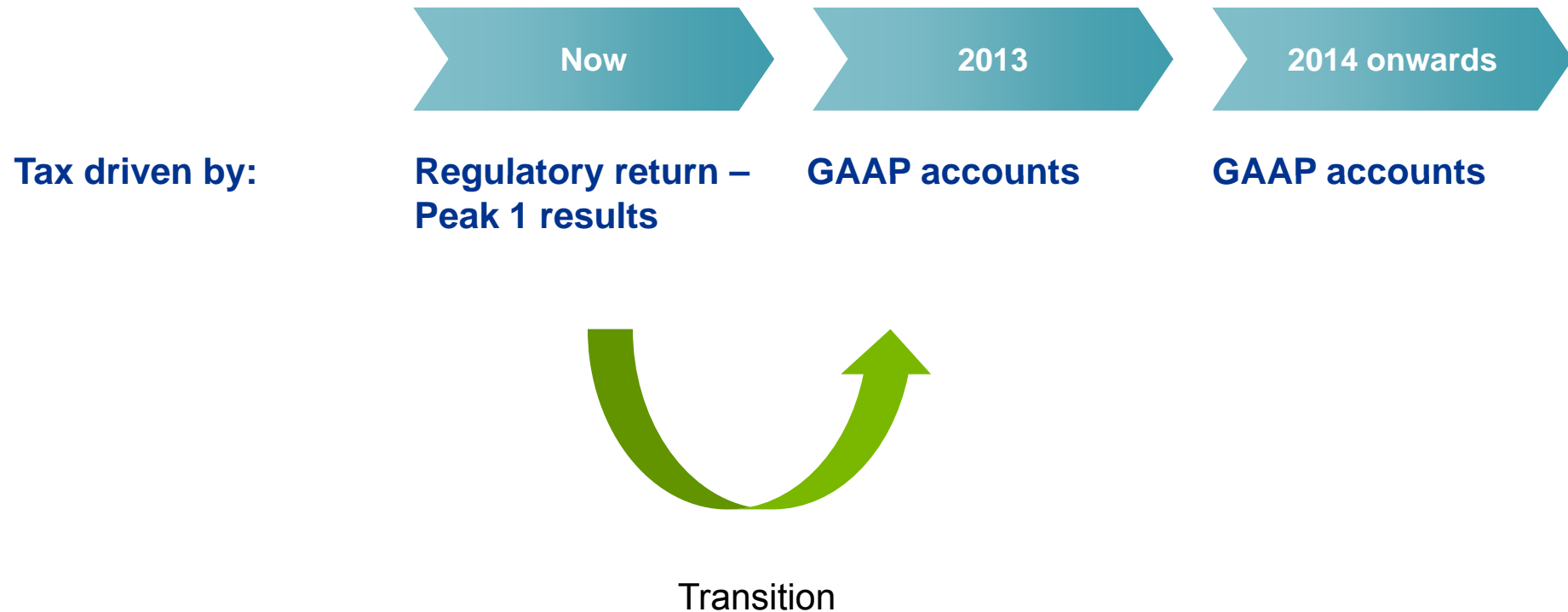
- Loss functions

4) SII and Tax survey results

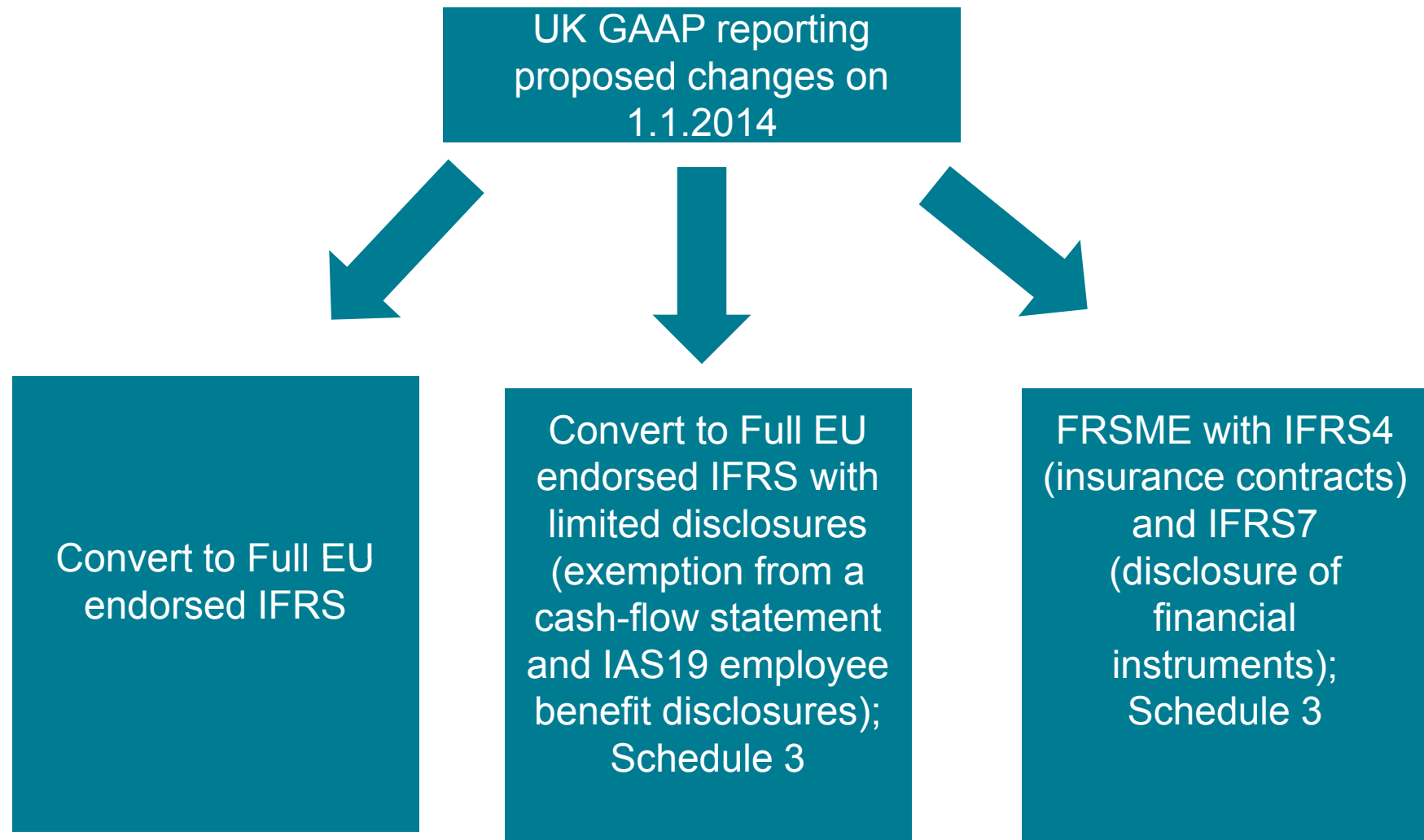
The big bang?



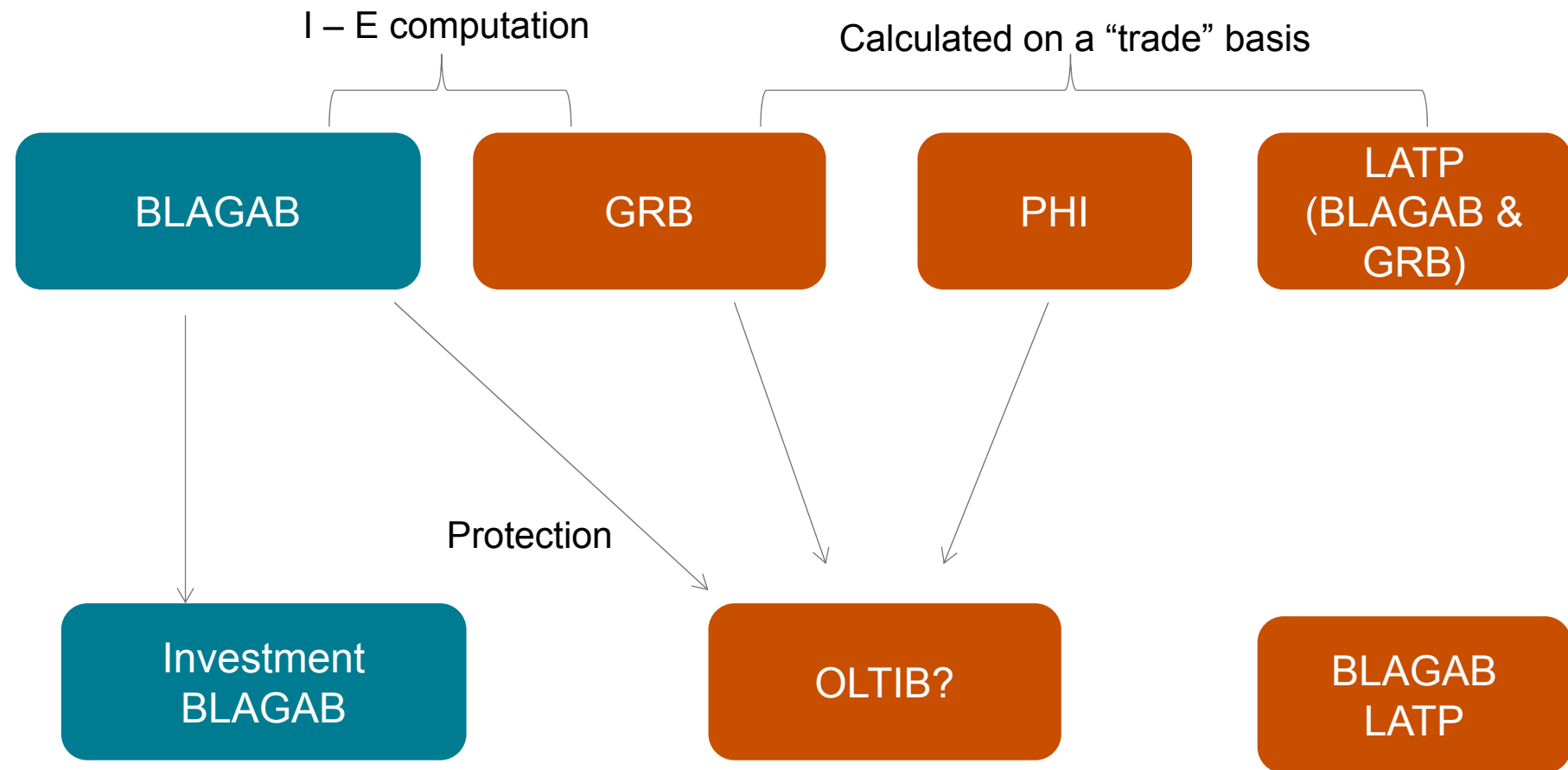
Background – Basis of life assurance taxation



What does this mean for UK GAAP reporting insurance companies?



The future tax categories for life assurance from 1.1.13



Protection contract

Per FSA Handbook glossary

(1) a [long-term insurance contract](#) in respect of which the following conditions are met: (a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;

(b) [deleted]

(c) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; and

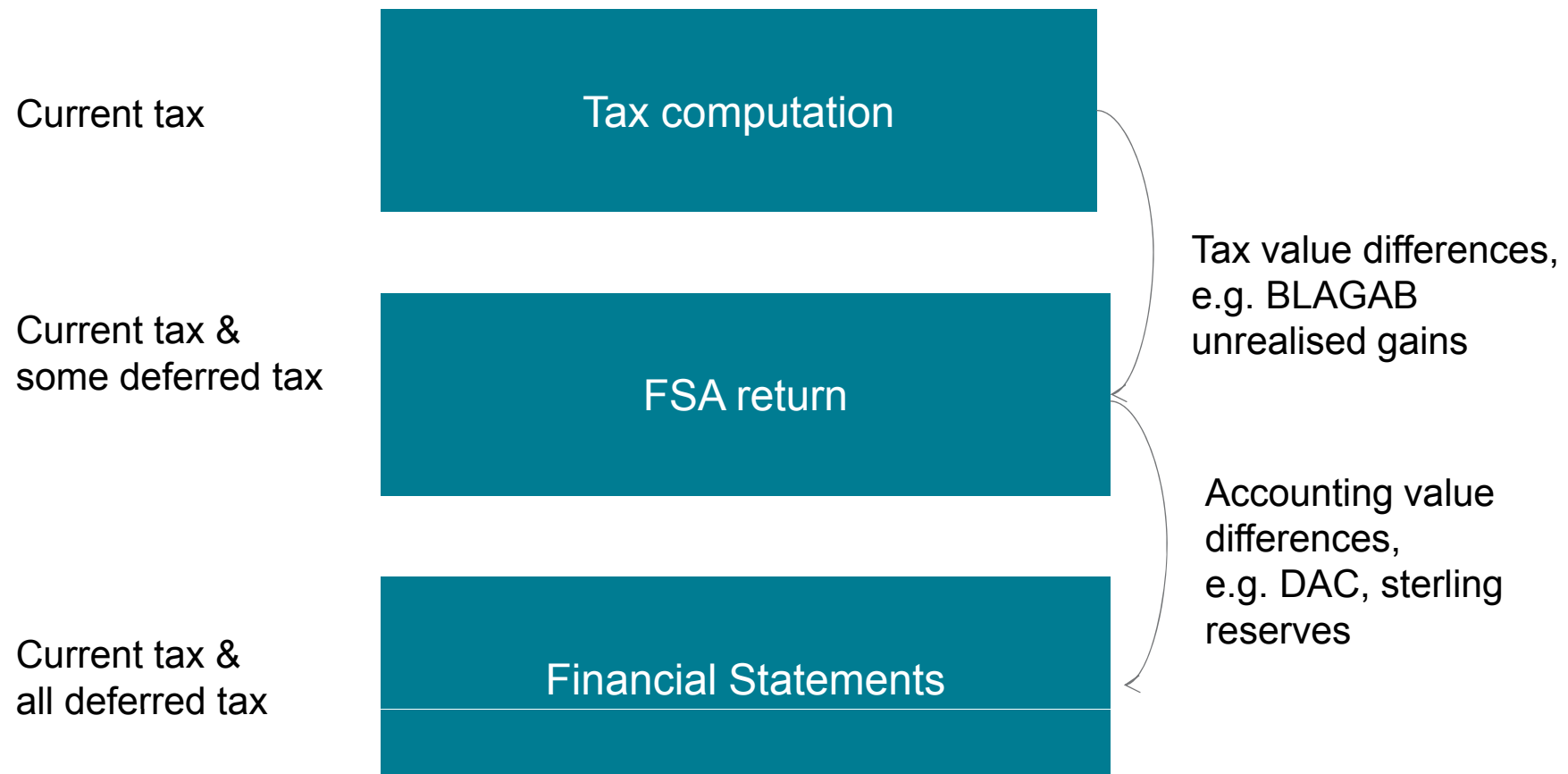
(d) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with (a) or (c); or

(e) [deleted]

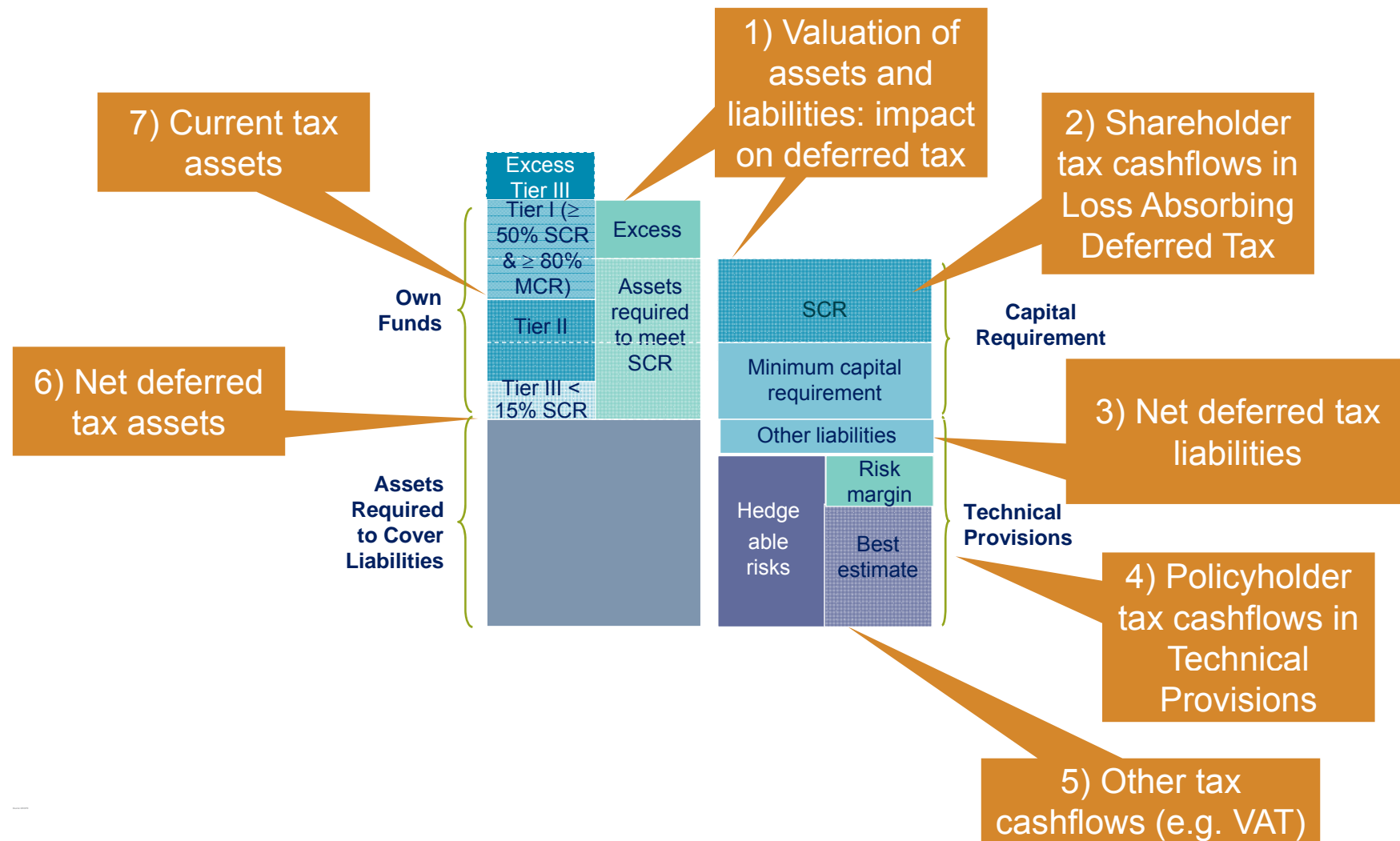
(2) a [reinsurance contract](#) covering all or part of a risk to which a [person](#) is exposed under a [long-term insurance contract](#).

Per HMRC (legislation expected on 6 December 2011 in the PBR)

Gentle reminder on how deferred tax is “calculated” currently



Where is tax in Solvency II?



Tax “cashflows” in BEL

What does QIS 5 state:

TP2.34

- Undertakings should take into account taxation payments charged to policyholders.

TP2.35

- Or which would be required to be made by the undertaking to settle the insurance obligations.

Translation of Solvency II “standards”...

Product pricing: $\Sigma (I + G) * 20\% ?$

Income assigned to a block of policies

Asset share: $\Sigma (I + G - E) * 20\%$

Income assigned to a block of policies

Tax computation (now): $\Sigma (I + G - E) * 20\%$

Income allocated using statutory formula

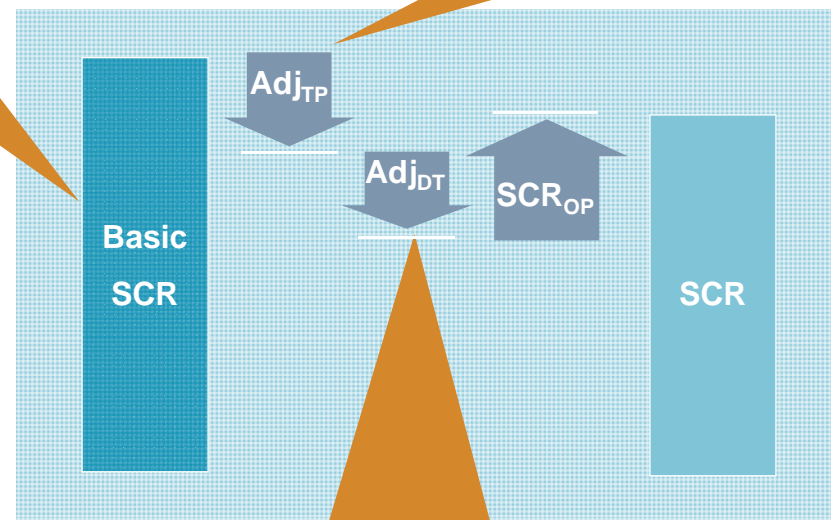
Some things to consider

- What is the relative quantum of BLAGAB reserves?
- Does the business plan focus on selling “investment” BLAGAB post RDR?
- Communication with the tax department?
- What is my product pricing policy
- Who has the responsibility for tax in BEL?
- Can I justify my simplifications?

Adjustment for loss absorbcency of deferred tax

The Basic SCR (gross of loss absorbing capacity of technical provisions and deferred tax) is calculated first

Adjustment for the loss absorbing capacity of technical provisions is then calculated



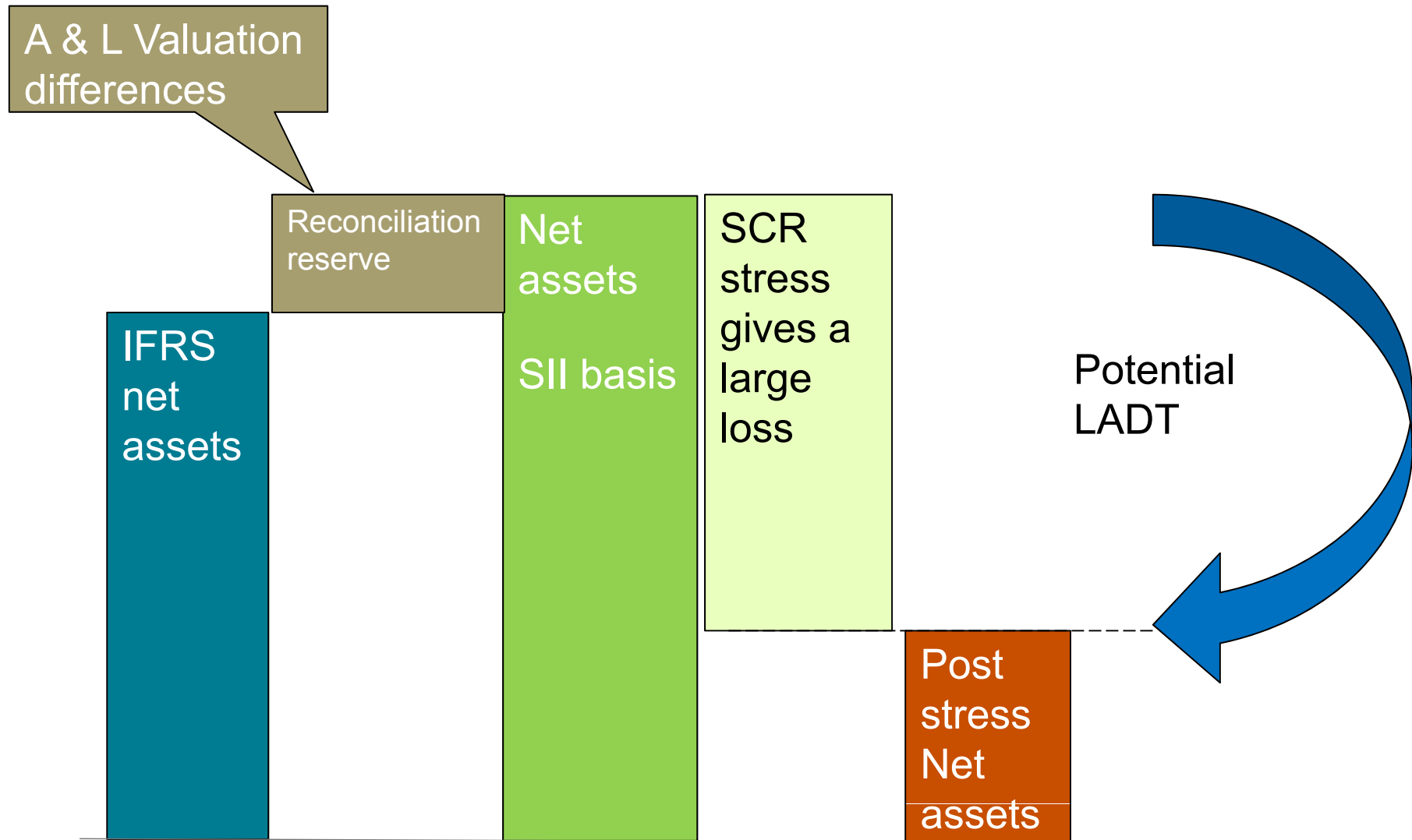
The adjustment for the loss absorbing capacity of deferred tax resulting from loss:
$$SCR_{\text{shock}} = BSCR + Adj_{TP} + SCR_{OP}$$

Loss absorbency of Deferred Taxes

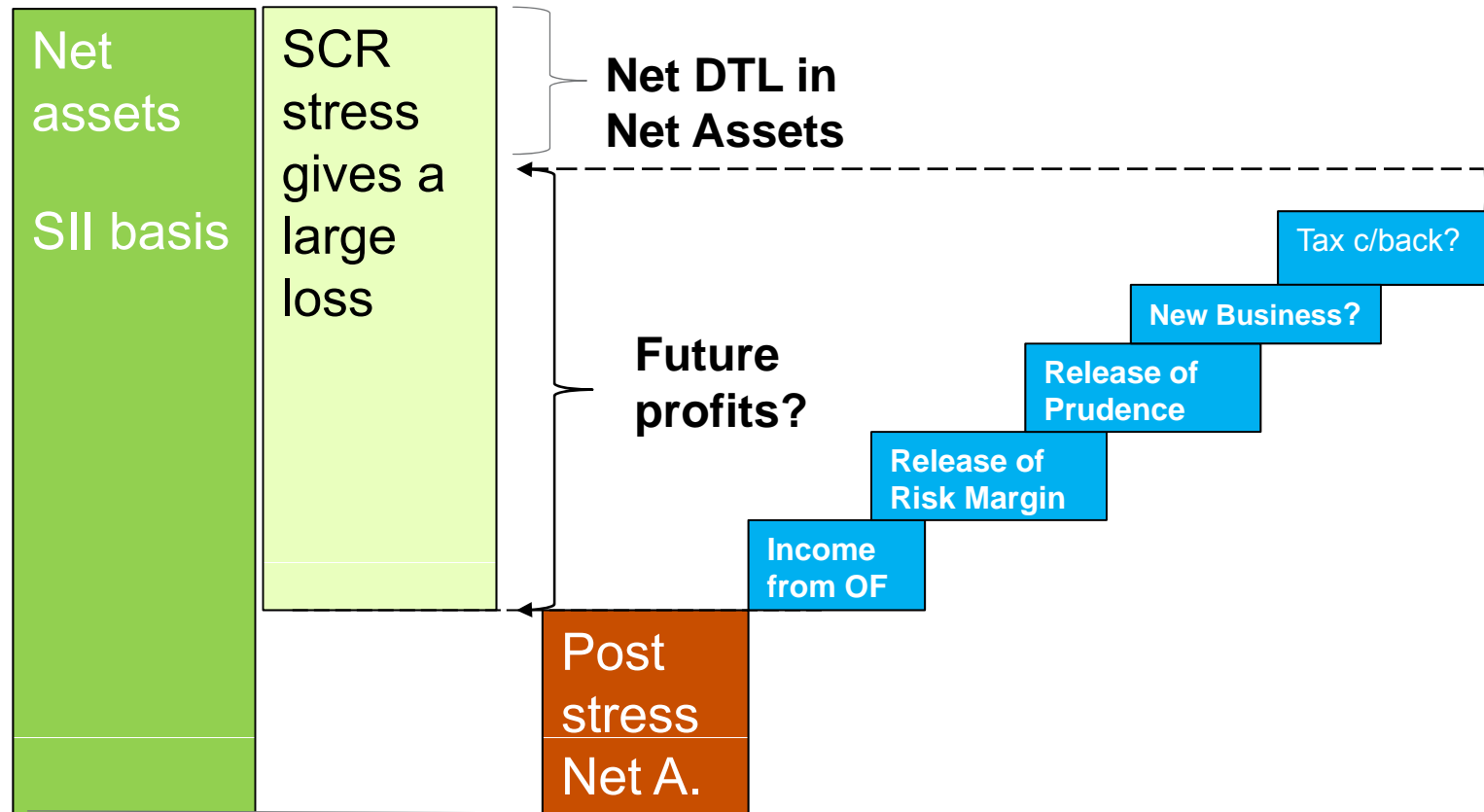
QIS5 SCR 2.14 / 2.15

- “...equal to the change in value of deferred taxes that would result in instantaneous shock”
- “....value of deferred taxes should be as set out in section on valuation”

IFRS versus Solvency II

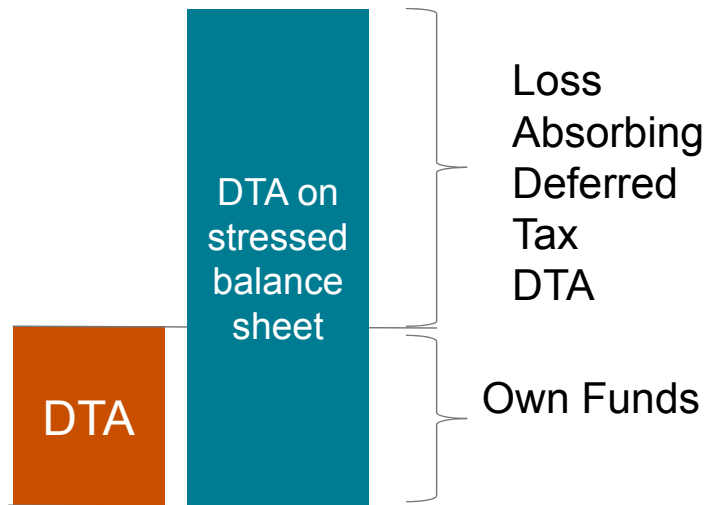


Sources of future profit?

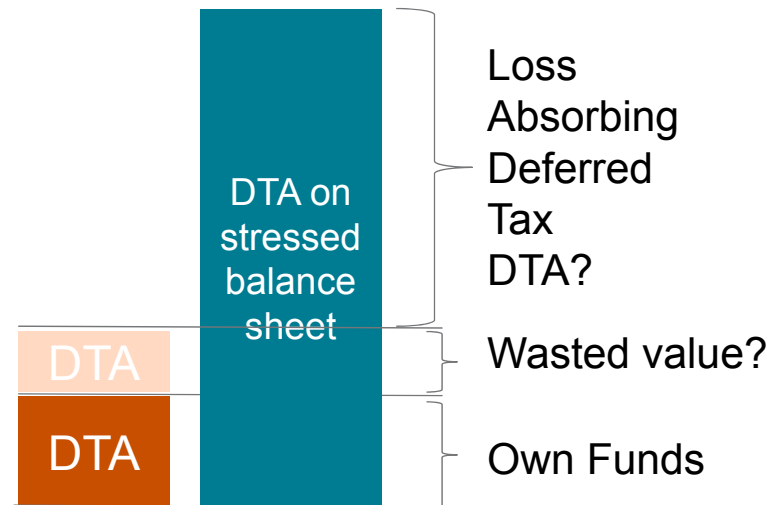


Application of the “standard”

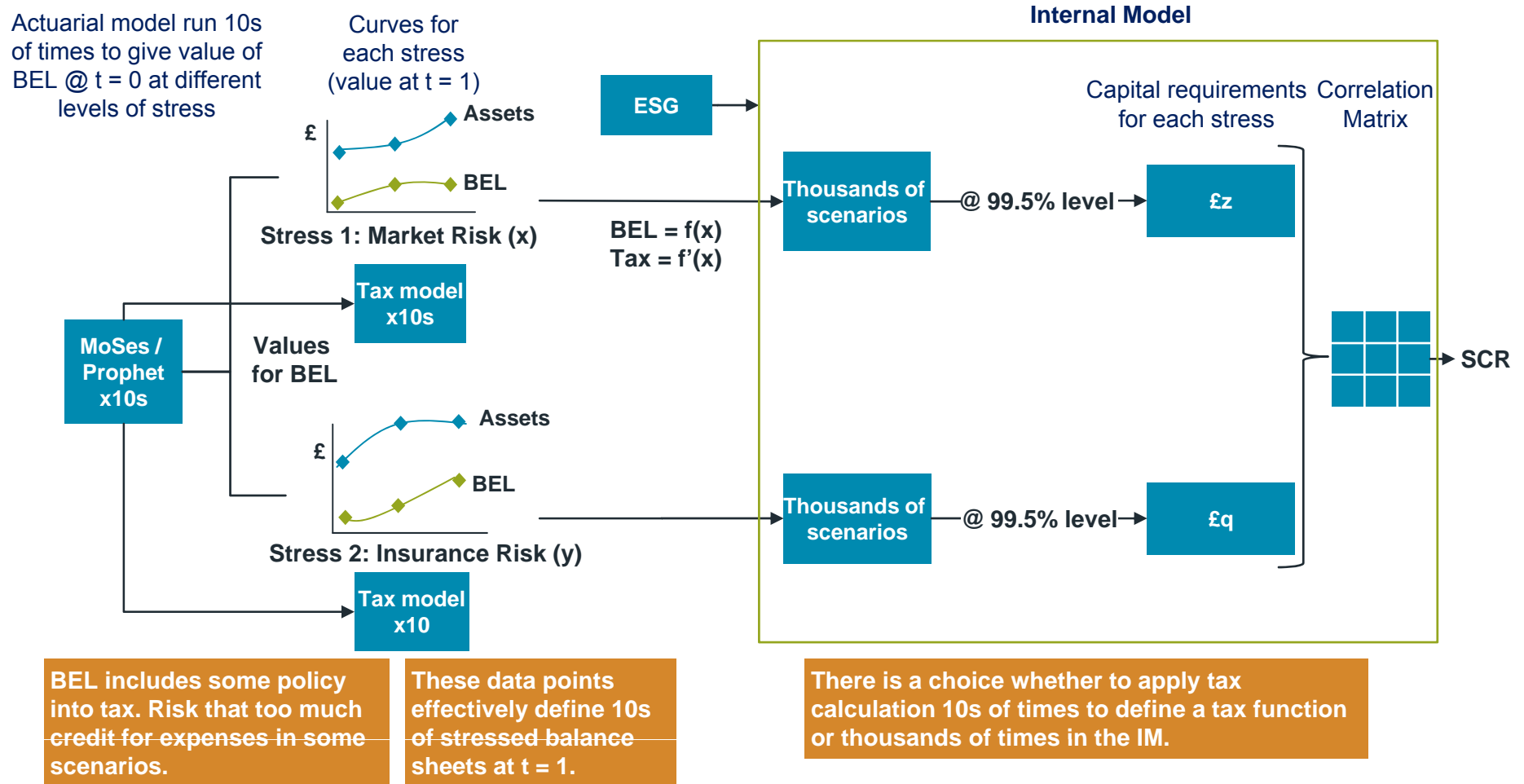
Scenario 1: No Tiering for 15% adjustment



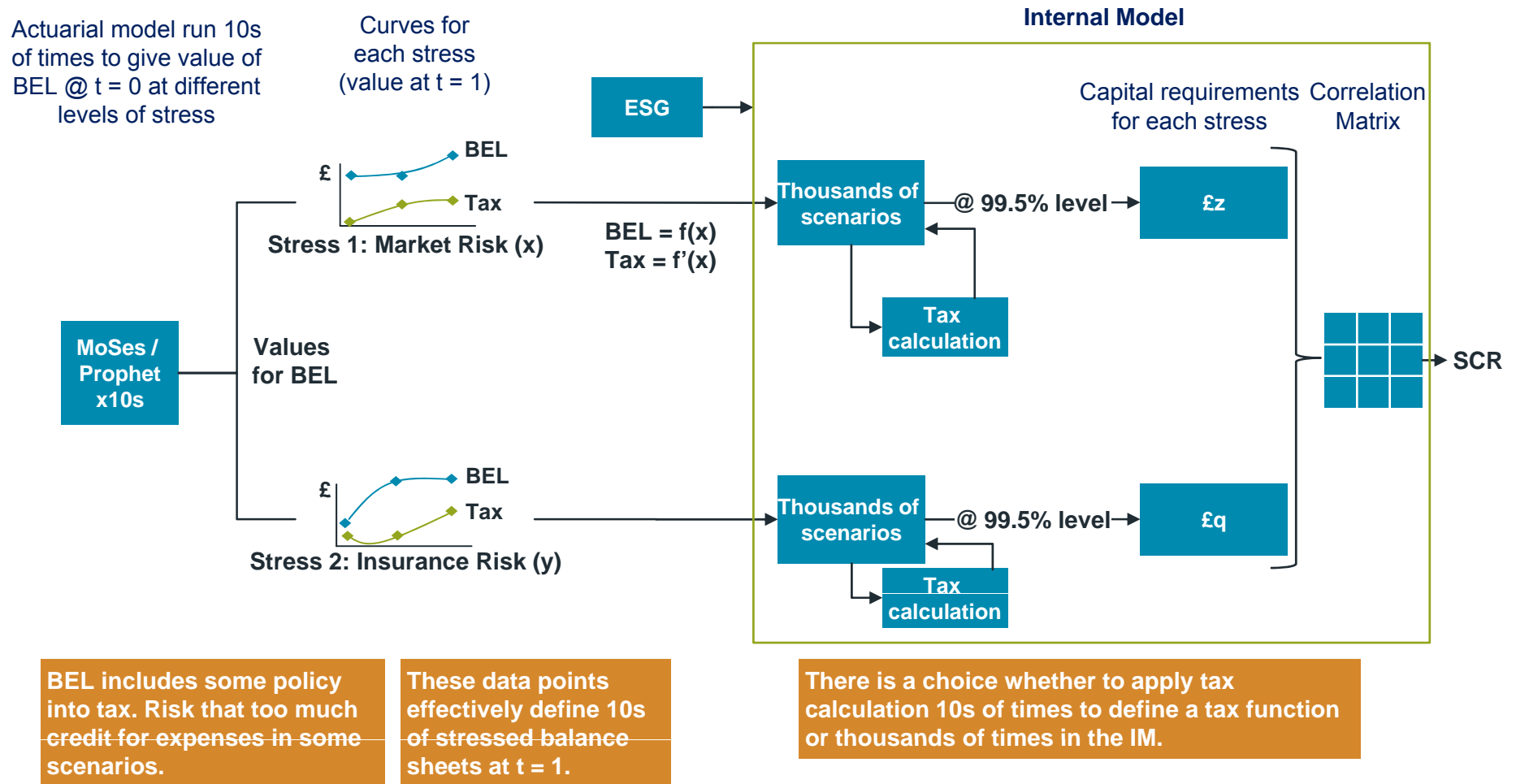
Scenario 2: Tiering bites adjustment



Tax and Internal Models: Post-Tax Loss Functions



Tax and Internal Models: Pre-Tax Loss Functions

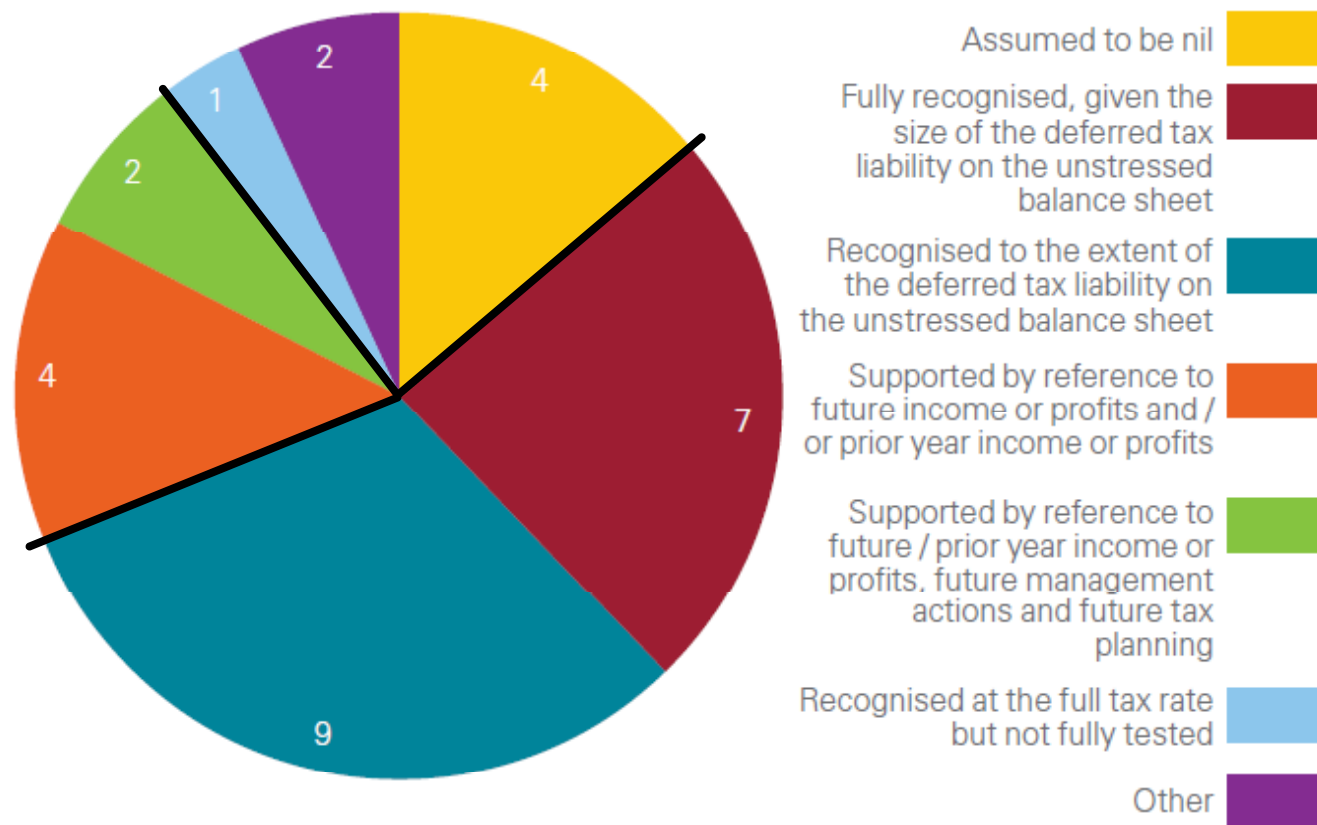


KPMG Solvency II Technical Practices Survey

- Survey sent in June and July 2011
- Survey participants
 - 32 UK life offices with internal actuarial functions
- The survey contained a mix of open response and multiple choice questions
- SII Topics addressed:
 - Project management and preparation for implementation
 - Calculation strategies around Pillar 1 liabilities and capital requirements
 - Treatment of Solvency II from an actuarial perspective
 - Pillars 2 and 3 and Own Funds
 - Impact of Solvency II on product pricing, tax and strategy adopted by groups

Deferred tax

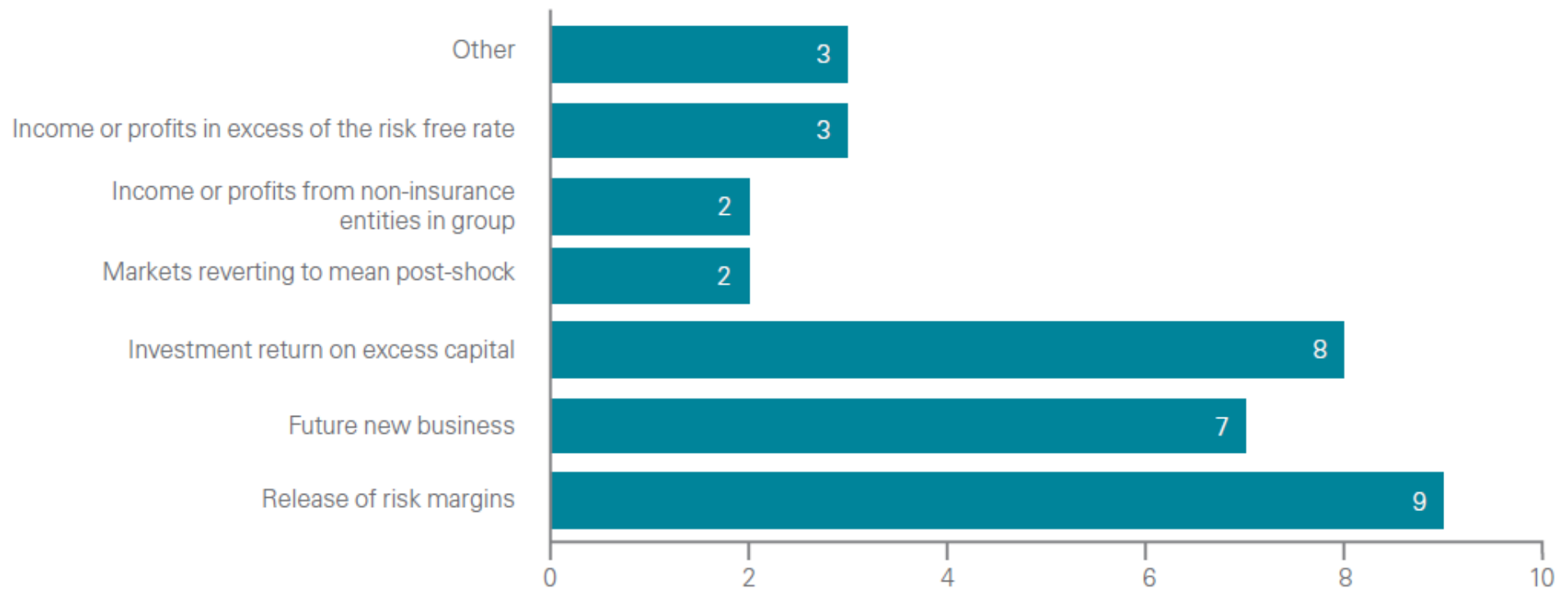
To what extent is the loss absorbing capacity of deferred tax recognised in the SCR?



- 55% - LADT recognised to extent of DTL's on base balance sheet (or in full where larger)
- 20% - LADT recognised to extent of future profit projections

Deferred tax (cont.)

Which sources of future income or profits are anticipated when valuing deferred tax assets?

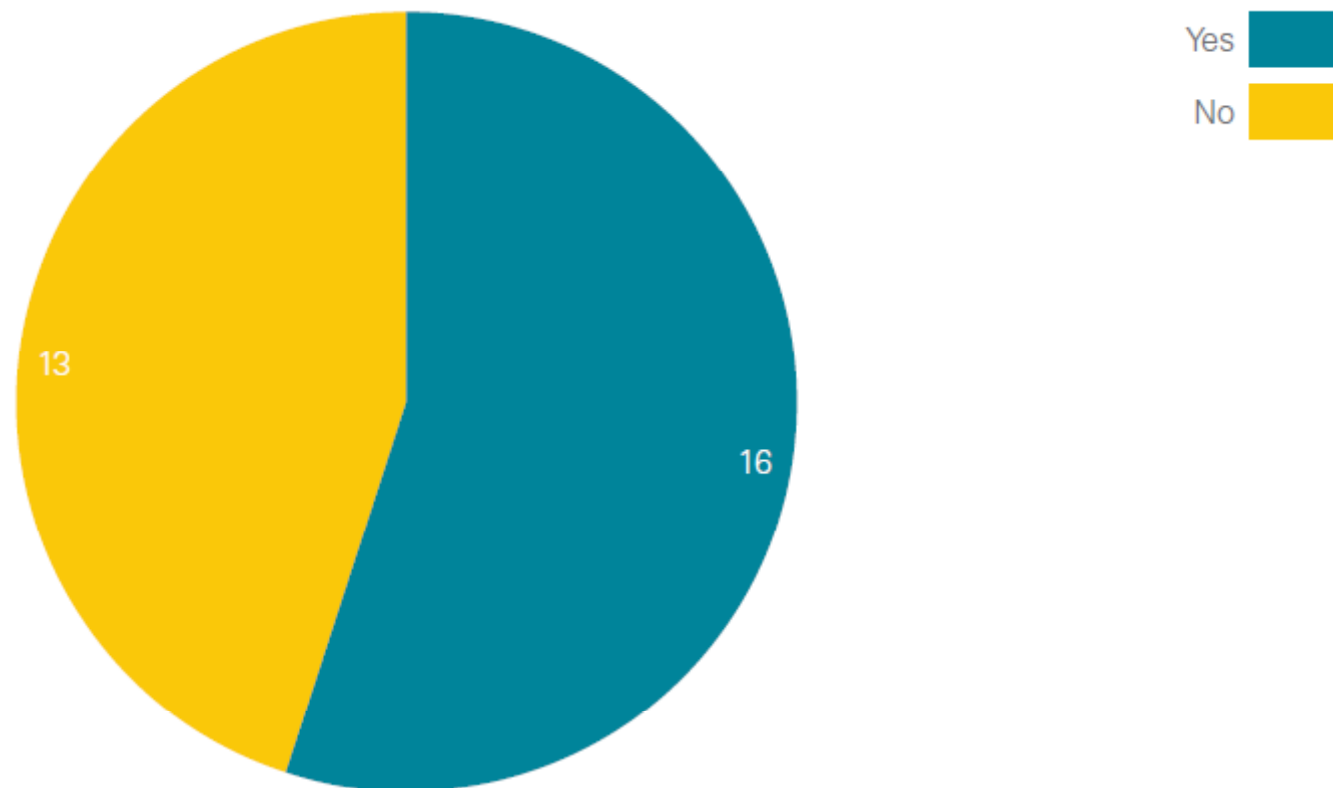


Note: 20 respondents to this question and asked in relation to both base and stressed balance sheet

- None of the above sources being used by more than 56% of respondents

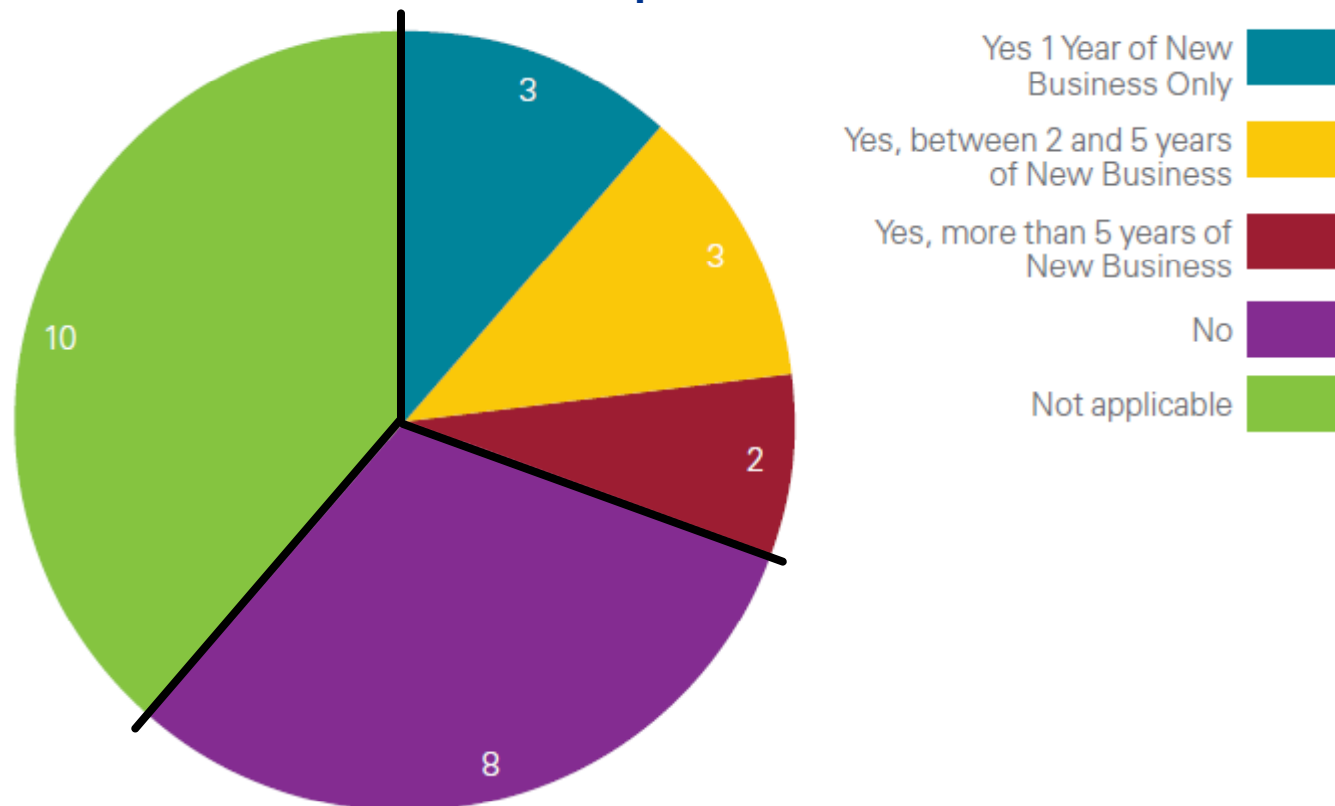
Deferred tax (cont.)

Are deferred tax assets and liabilities discounted on the SII balance sheet?



Recognition of DTA on stressed balance sheet - Source of future profits

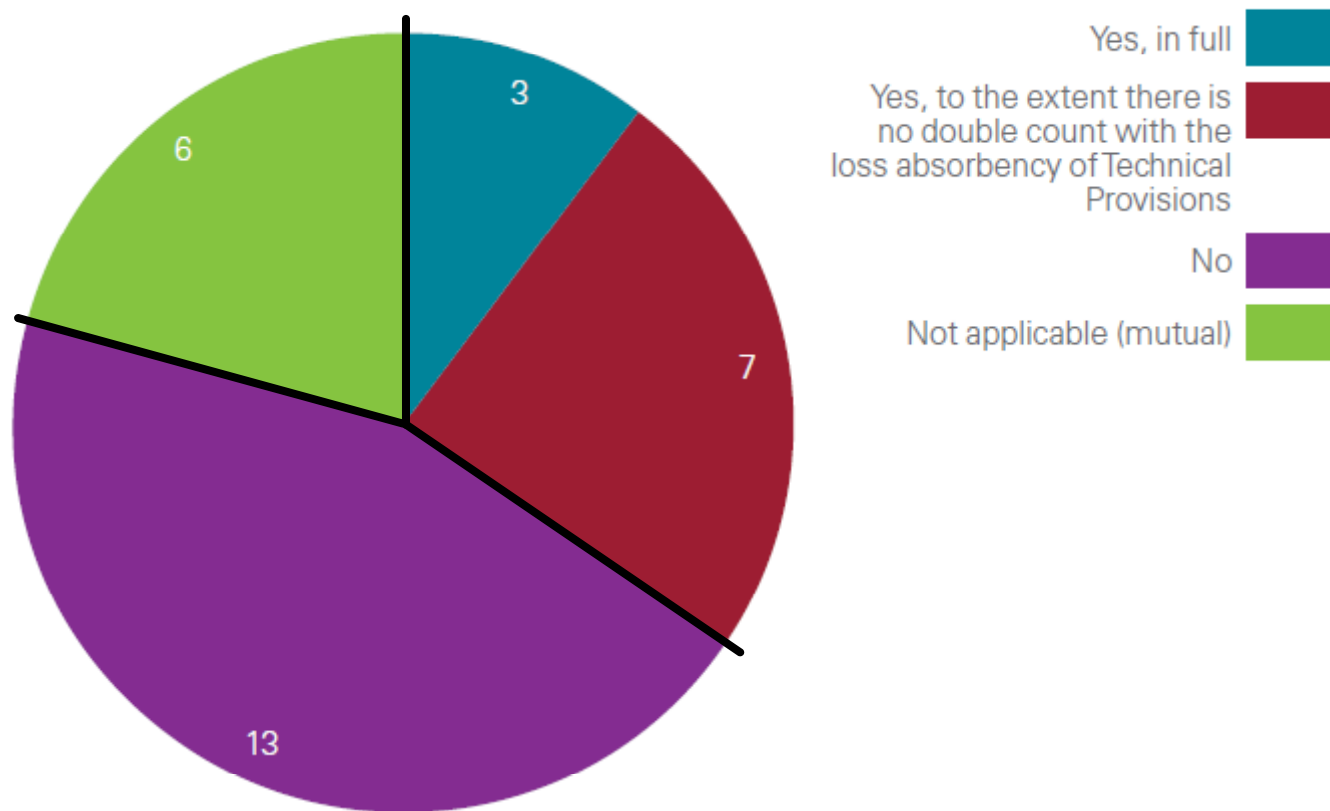
Are future profits from new business anticipated?



- Even split between yes and no
- No consensus on number of years

Recognition of DTA on stressed balance sheet - Source of future profits (cont.)

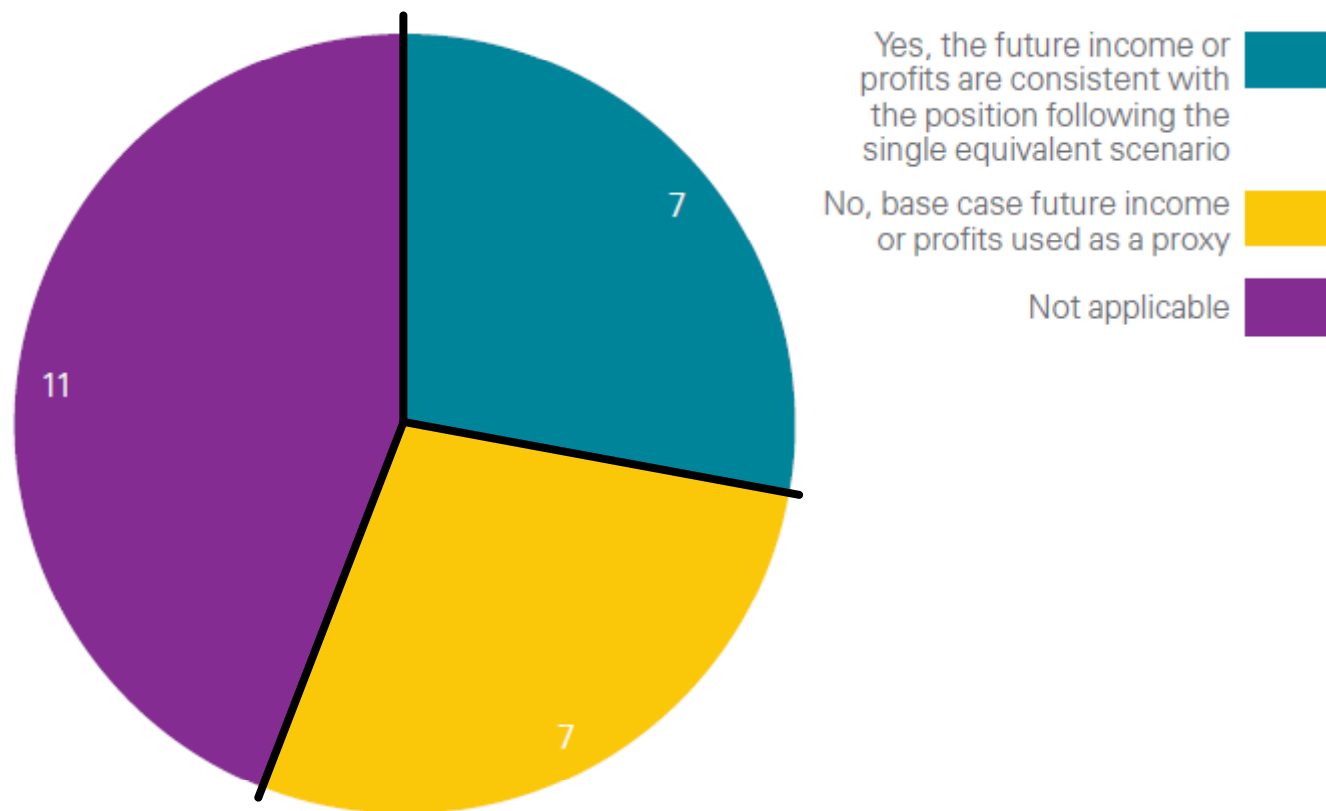
Anticipating future profits from release of risk margin?



- 43% of respondents will use release of risk margin as a source of future profits

Recognition of DTA on stressed balance sheet - Source of future profits (cont.)

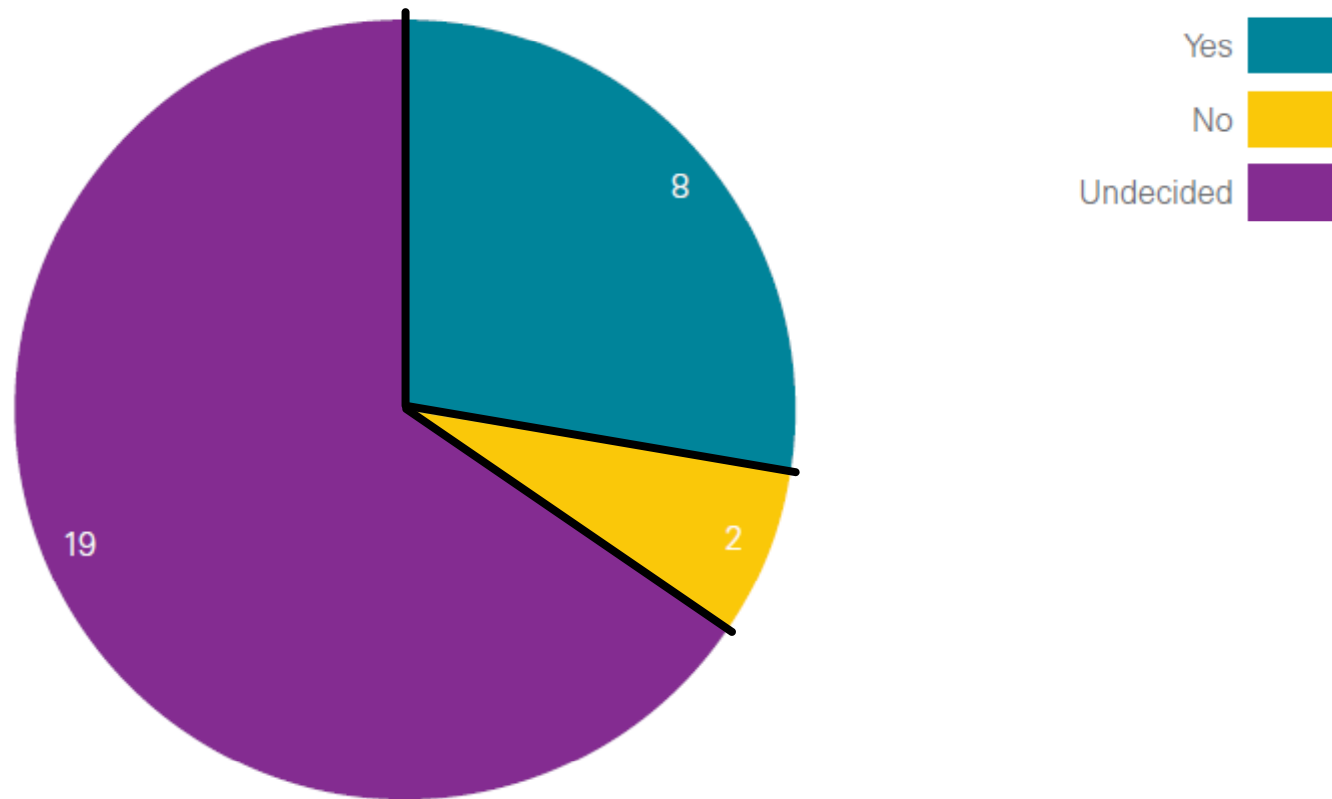
Are profit projections scenario specific?



- Even split between yes and no

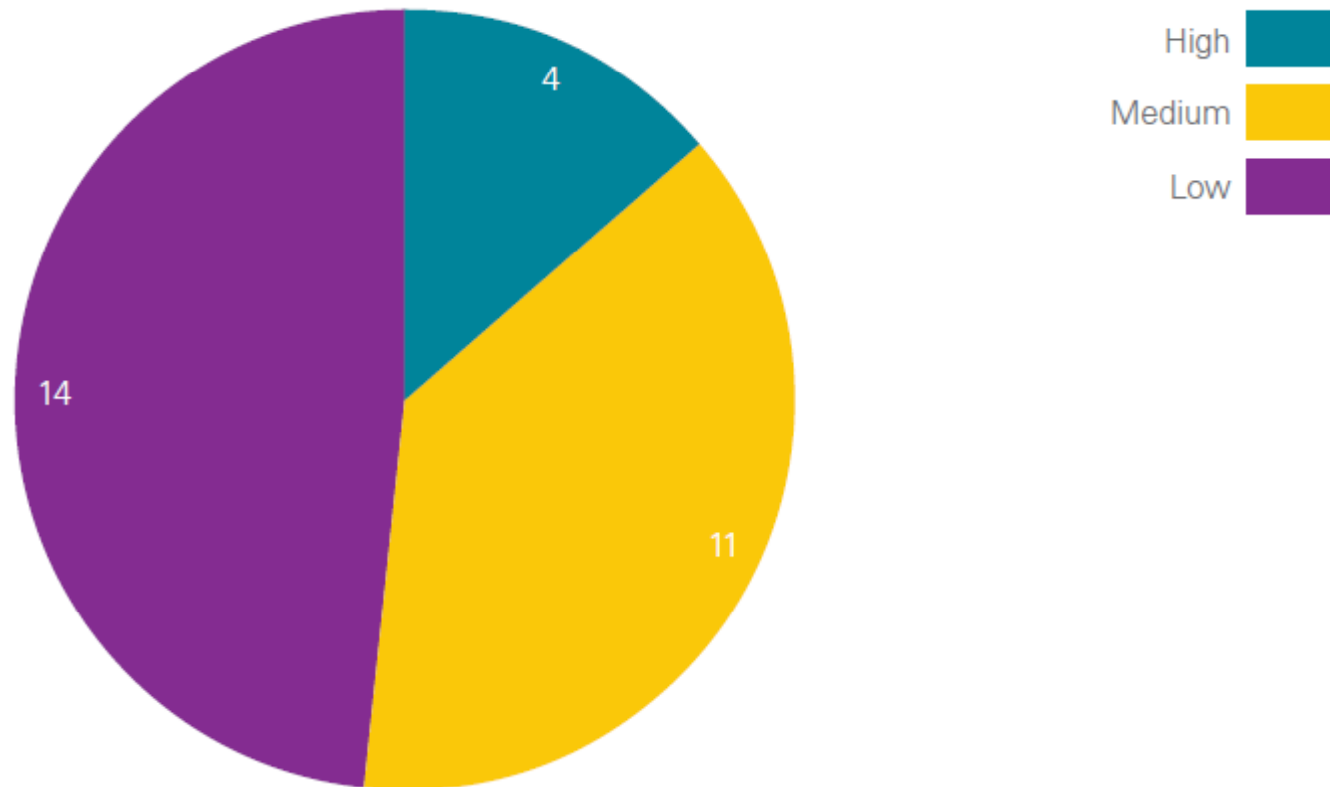
Deferred tax asset recognition simplification

Would you support a simple flat rate approach to deferred tax asset recognition?



Sophistication of tax modelling

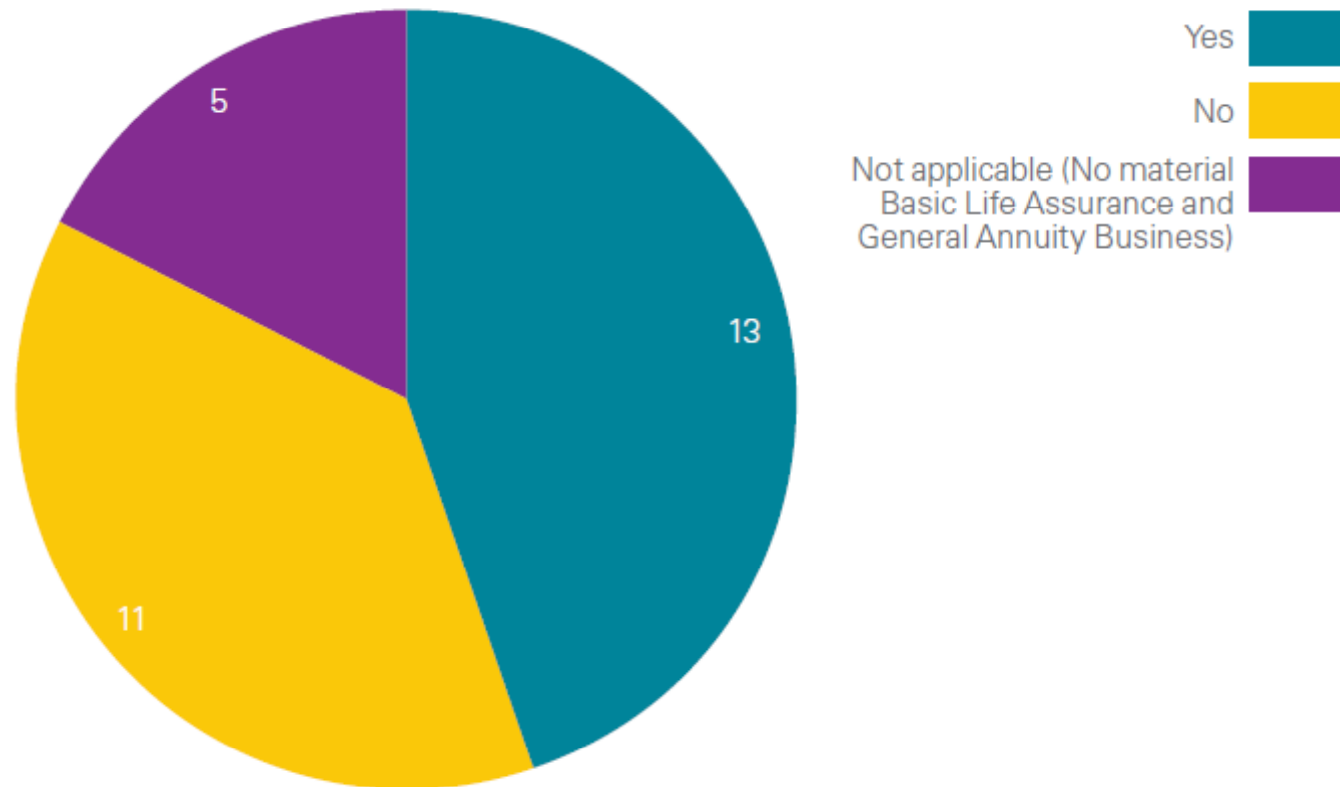
How sophisticated is the treatment of tax in your internal model or std formula SCR?



- Small and medium respondents – all either low or medium
- Where LADT was nil, sophistication was low

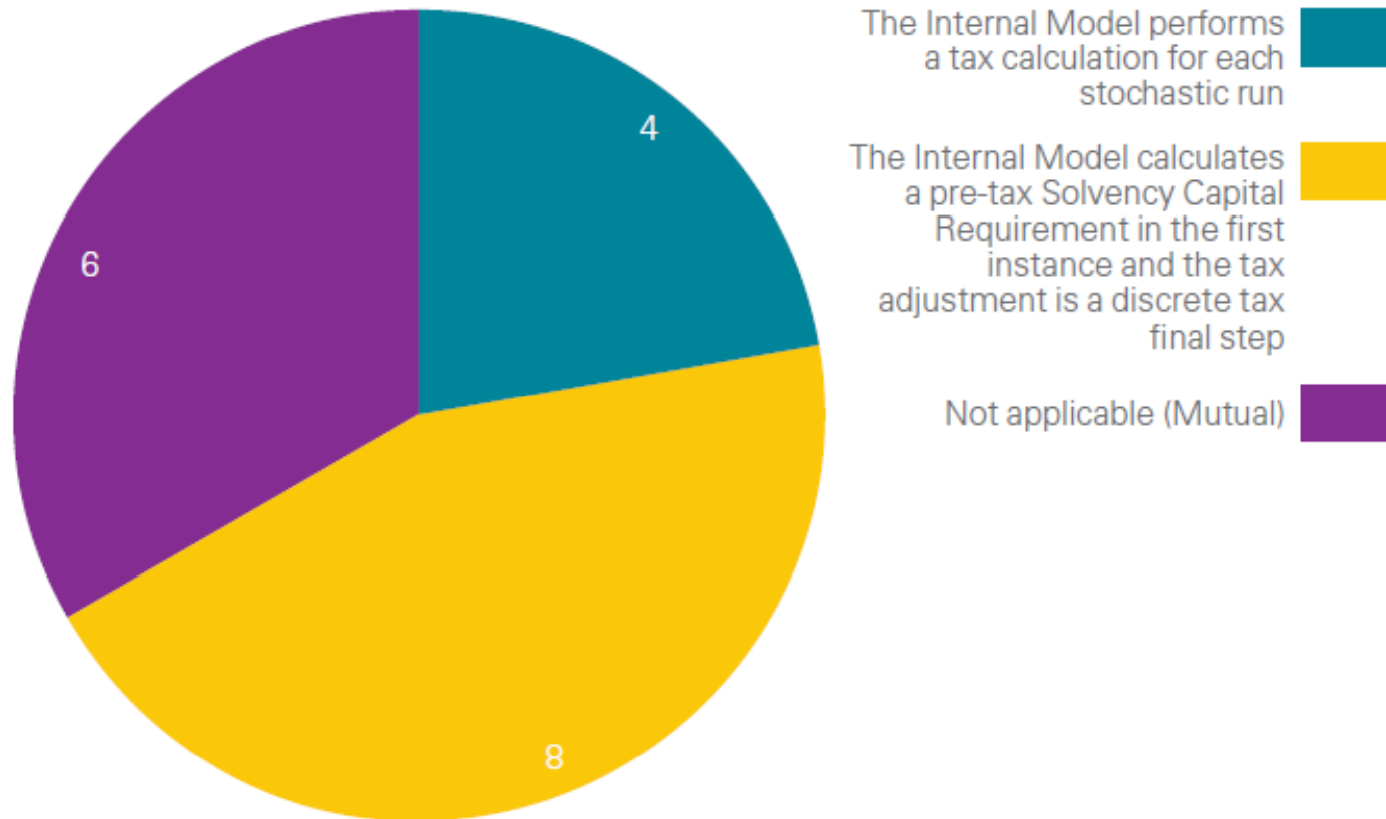
Tax in the internal model

Do you consider the behaviour of the deferred policyholder tax component of BEL under stress?



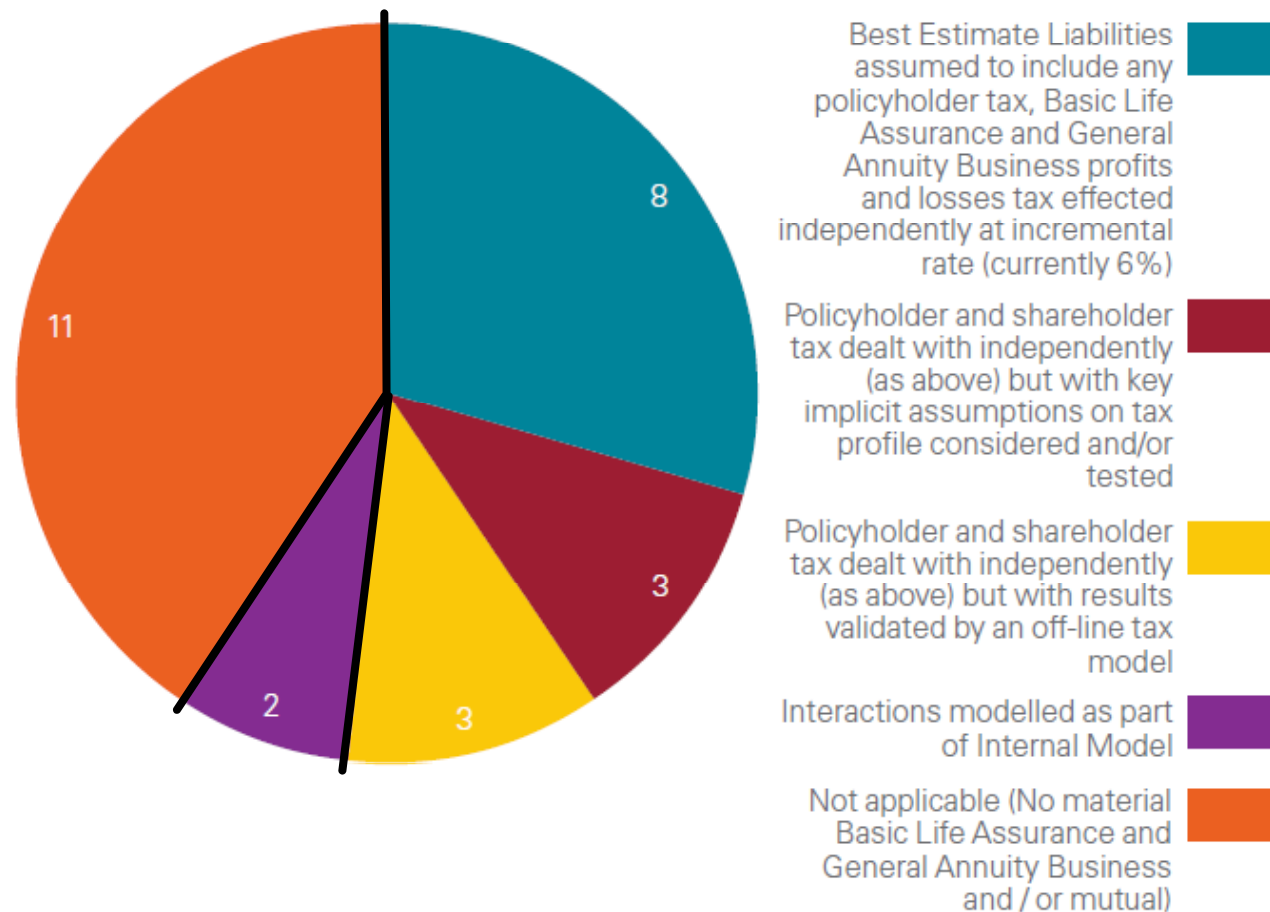
Tax in the internal model (cont.)

How is shareholder tax accommodated in the calculation of the Internal Model SCR?



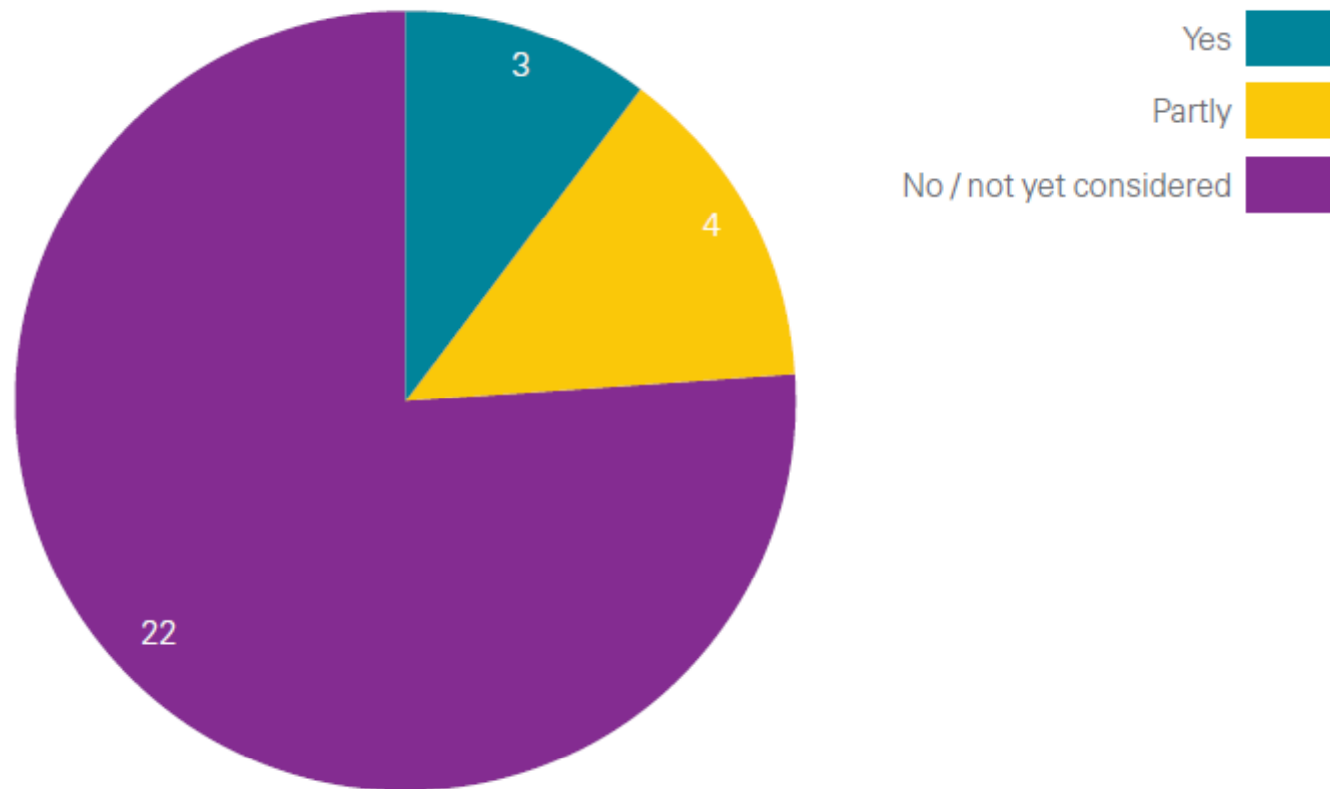
Tax in the internal model (cont.)

How are interactions between policyholder and shareholder tax allowed for?

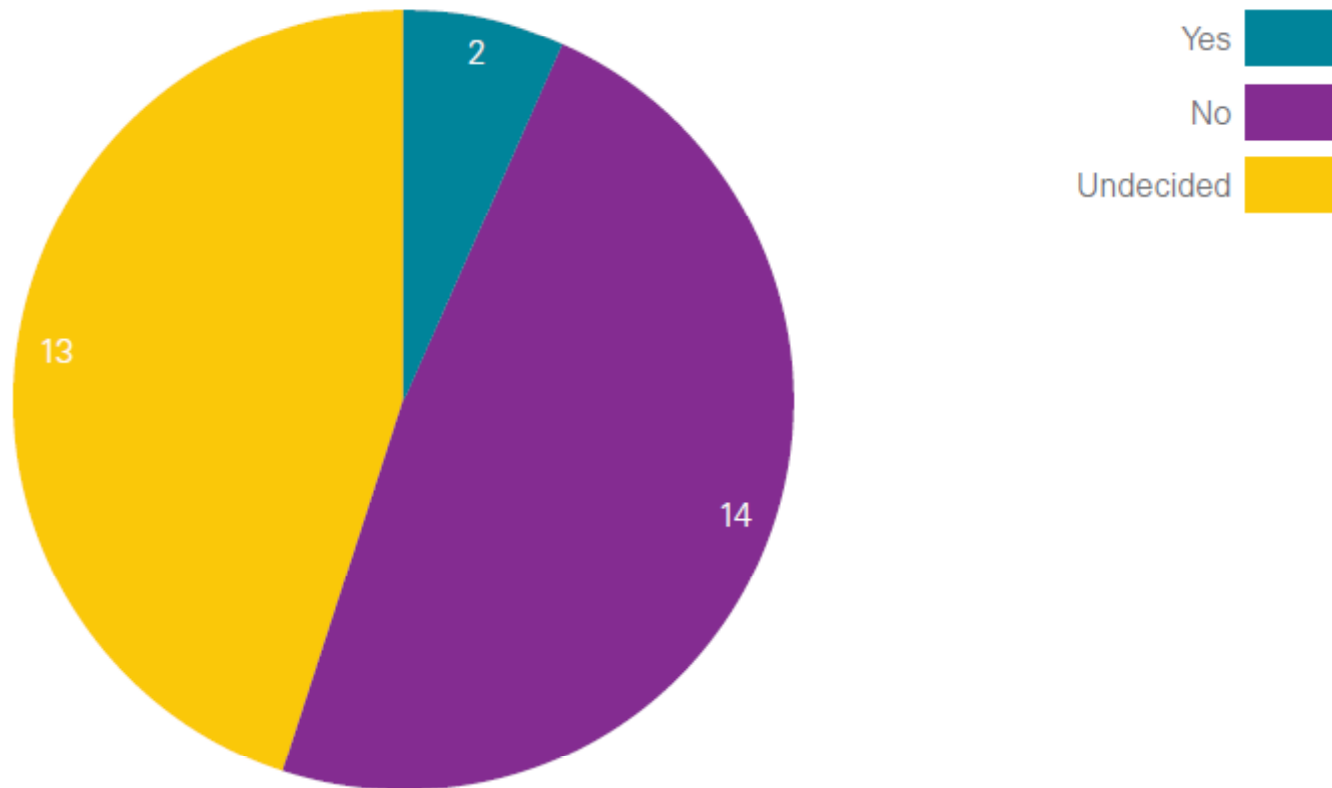


Tax in the internal model (cont.)

Are the tax assumptions in the IM consistent with the expected post 2012 tax regime?



Companies claiming R&D tax credit on Solvency II project spend



Guidance

Current uncertainly

- Will conservatism creep into guidance on tax?
- Will the “wait and see” crowd have all their questions answered?
- What evidence will supervisors require to support deferred tax asset recognition?
- Are there any categories of future profit or assumptions which the regulators will not accept?
 - Going concern?
 - Management actions?
 - Others?
- If so will such views be consistent between regulators across Europe?
- Will regulators allow some common sense to accept well reasoned logical positions which, due to oversights in drafting, may not accord with the letter of the rules.
- To what extent will guidance issued in respect of the Standard Formula explicitly or implicitly apply to the Internal Model?

Survey Link

Life Assurance Technical Practice Survey:

<http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Pages/technical-practices-survey-2011.aspx>

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



Thank you

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